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State Ministries (Housing & Urban Development)  
Estate surveyors and Developers  
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Research in Buildings, Environment and Housing  
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Time for paper: 30 minutes  
Topic: **Critical issues in the development of viable Housing Finance industry in Nigeria**

### **CURRENT TRENDS IN HOUSING FINANCE**

Over the last few decades, comprehensive studies of housing markets and housing finance systems across the world have created a shared body of knowledge on what constitute effective and non-effective housing policies and housing market regulations. In particular, programs to finance social housing are perceived differently today than a few decades ago, both in developing countries and advanced economies. The focus is on creating well- functioning housing markets and the expansion of a safe and sound housing finance system.

Housing finance systems in many developing and emerging economies share several characteristics. First, most housing finance systems are, “institutional patchworks” that comprise private sector lenders as well as several government-managed housing finance institutions or programs (Renaud, 1997), in the form of special government housing “banks” or special housing funds capitalized by payroll taxes. These institutions stifle competition in the financial system because of their access to low-cost government funds and prevent innovations in the way housing finance is provided. In most countries these programs are dominated by special interests, and allocation of funds to either private borrowers or construction firms no longer focuses on disadvantaged groups. The private banks do not consider long-term lending for housing a priority because of the associated risks in non-integrated financial systems and the predominance of government finance programs catering to the same professional middle class to which the financial sector might want to extend their services.

Second, many government programs use interest-rate subsidies on fixed-rate long-term mortgages which have some negative characteristics:

- 1) the funding and cost of special government lending programs to the economy is non-transparent, i.e., it is not on the budget and increases with inflation;
- 2) The subsidized interest-rate programs stimulate debt acquisition rather than savings, in other words the more one borrows, the higher one's subsidy (see

Renaud, 1984, 1997; Diamond, 1997; Hoek-Smit, Diamond and Bovet, 1997; Hoek-Smit, 1998 for analyses of housing finance systems in Latin America, Asia and Africa).

As a consequence, the formal housing finance system only provides mortgage loans for a small proportion of newly constructed houses and home purchases. A much larger proportion of households than necessary have to finance housing from savings or build incrementally and at a low standard because upfront finance that would allow them to purchase a higher quality home and pay for it over a longer period is not affordable or inaccessible. Of course, formal finance is inaccessible for many households in developing countries for other reasons. These include insecure and undocumented incomes, a lack of land and housing options for middle and low income households that are acceptable as collateral to banks, and the high costs and related lack of interest by the banks to work with small clients, to name just a few. Increasingly, developing countries move towards a more integrated modern housing finance system.

First, there is a trend to increasingly rely on capital markets as sources of funds for primary housing finance lenders rather than on depository institutions alone. Second, it has been shown that, if assistance to low and moderate income households is necessary, subsidy programs are best designed to allow households to participate in the housing market, rather than provide public housing. Third, support to moderate income borrowers to acquire loans through the private financial sector has proven to be most efficient if it is provided as a direct demand subsidy in combination with other facilitating measures and incentives to the banks rather than as interest-rate subsidies through segregated government lending programs and institutions. This way, mixing subsidized finance with market-based lending is avoided in order not to distort prices and create disincentives for expansion of the private finance sector (e.g., preventing access to capital markets). Fourth, for those households who cannot use the private sector for their housing finance needs, even with incentive programs, special social housing funds or lending mechanisms are used that provide shorter-term and smaller loans, at concessionary rates if necessary, but which are clearly separated from the rest of the housing finance system. Both types of finance subsidies are set up to be efficient, transparent and well targeted to those who cannot participate in the formal housing finance sector without such support.

Many Latin American countries (e.g. Chili, Costa and Rica) and several South Asian countries (e.g. Malaysia, Thailand and India) have initiated a fundamental restructuring of their housing finance systems according to these principles. Even though all countries have a different history in the development of their housing and housing finance system, it is important to make use of the experiences of other countries with a similar economic and financial background.

In Nigeria, Housing finance as an institutionalized mechanism in the normal sector of the economy started with the establishment of the Nigerian Building Society (NBS) in 1956 as a joint venture of the commonwealth Development Corporation, the Federal Government and the Eastern Nigerian Government. Based on research and findings the conclusion is that we cannot copy models from other nations but rather evolve workable models based on our socio-cultural background.

## **HOUSING AS A SOCIAL PROBLEM**

The literature on economic development abounds with references to the 'social' nature of the Housing requirement. This phrase is used to distinguish the housing sector from other capital intensive sectors of developing economies such as manufacturing. The implication, which is often made very explicit, indeed, is that while there is no 'economic' need for housing investment since the market demand for it appears very weak, it ultimately must be provided in order to solve a "social problem." According to research and findings, Housing sector is regarded as a drag upon the process of economic growth (Smith 1970). While it is admitted that housing must be provided or improved eventually, many national economic development programs regard housing as a form of investment eminently able to be postponed. The longer it can be put off, the reason goes, the better the result for the nation as a whole.

The big question is how does Housing come to be excluded from the category of 'economic good's' so that it must be bestowed as a kind of social security benefit? Housing as a 'social good' is not a universal concept. There are portions of the world in which the satisfaction of demand for Housing and Housing improvements is a rewarding private business which does not lack eager participants and which seems to produce, as in the United States, a general level of housing welfare which is widely envied. Nevertheless, in many parts of the world, Housing is regarded as a demand, which cannot and should be not satisfied by the market and, hence, must be distributed as a form of public largesse.

The perception of Housing as either 'economic good' or 'social-good' will determine the level of investment and government involvement in its production and distribution. When seen as a 'social good', Housing market is subjected to political uncertainty and statutory intervention. In such circumstances, private involvement is discouraged for investors will be unwilling to take the risk. Our land policy is an example of such restraint.

## **EVALUATION OF EXISTING METHODS OF FINANCE**

### **Traditional Methods**

Prior to the colonial period, many methods of housing finance were adopted in different parts of the country. Amongst these are Esusu and Ajo, Age grade association, Village development scheme, and Town unions of people living outside their place of birth. Others are Men's revolving loan association, Loans from traditional moneylenders, Social club contributions, Aaro or Owe where members contribute in kind by providing labor on members' site until the circle is completed. All of these methods were successful in the provision of finance for housing and its delivery in the traditional setting. But with the complexity in economic activities, these methods faded away and are "to be replaced" by modern methods.

### Modern Methods

The sources of housing finance in existence today can be grouped into two that is, Formal and Informal. The formal sector comprises institutions operating within the statutory guideline stated by Federal Government. Among these are:

- **FMBN:** The Federal Mortgage Bank of Nigeria (FMBN) started operation in 1977 with the following main functions: The provision of long term credit facilities to mortgage institutions in the country; the encouragement and supervision of the activities of the mortgage institutions; provision of long term loan to individual and property developers for house building, produce saving facility, carry out research on mortgage finance. These activities have been marred by administrative ineptitude, political instability and uncoordinated policies.
- **Universal Banks:** This category of bank falls under retail banking by operation. They only lend on short-term basis because they have to meet the withdrawal request at the shortest notice. This has not been compatible with housing finance, which requires long term finance. This has limited their success in housing finance.
- **Specialized Development Banks:** This category included the Nigerian Industrial Development Bank (NIDB), Urban Development Bank etc. They were established to grant long term finance that possibly last sometimes up to 25 years for industrial, commercial, agricultural and housing development. Though ideally suited for housing finance, their success in housing finance was very limited due to inadequate funding and diversion of the little available funds into the short-term sector.
- **Insurance Companies:** Life funds of insurance companies are long term savings in form of annuities or endowment policies, which can only mature at the occurrence of certain known events, like death, accident or retirement. Their long term sources of funds enables life assurance companies to invest primarily on long term capital assets like real estate investment and get involved in the following: Loan for real estate development based on capital value of the policies, investment in mortgage and debentures; direct investment in or development of real property. I.e. acquiring or developing landed properties apart from those meant for their own occupation. Insurance companies are suited and equipped to finance housing development but due to their preference for higher return, the Nigerian Insurance industry has not played a significant role in housing finance, so far.
- **Pension Fund:** The Pension Fund Administrators (PFA) fund collects funds from employers and employees towards their retirement. This gives them access to long term funds and put them in good position to finance housing development. Pension funds, collect funds from employers (especially government organizations and large business concerns) and employees and therefore have long term obligation since employers can only receive their benefits or retirement gratuities only after having their jobs. Thus, they usually look for investment that offer long term prospects and are inflation proof like real property development or acquisition. They also offer loans on long-term basis to building societies and mortgage institutions.

The informal sector of an economy is distinguished from the formal sector by the extent to which government is functionally cognizant of the activities carried on (Akanji 1998). As an illustration, most informal sector transactions are not taxed nor are they registered in the national income accounts. It is amazing to realize that this sector accounts for about 60% of urban labor force. Some informal sector finance sources for housing are as follows: Personal or Family Savings, Individual moneylenders and, Voluntary Housing Movements.

### **Corporate Bodies**

It has become evident that despite most companies' huge profit, there was total neglect of the need to solve the obvious housing problems of their workers. This compelled the promulgation of employees Housing Scheme (Special provision) Decree 54 of 1979. The main provision of the decree is that any employer of up to 500 employees should provide minimum of 50 housing units out of which three-quarters should be made available for non-executive staff. The decree put in place a structure for identification of such category of employees and implementation of the decree. It also provided for the establishment of a Housing Loan Board by the state. This program though laudable in the sense that the end users of housing could easily be reached, never really took off. With enabling environment created, it would have been the best way to finance housing without going through intermediaries which eventually increase cost.

### **Developers/Contractor Financed**

Private property developer and other investors have applied various financing techniques like: Turnkey, Pre-letting and, Joint financing, (loan syndication) to finance housing project in Nigeria. Unfortunately, the overall housing demand is so enormous that their impact is minimal.

### **National Housing Fund (NHF)**

For a housing finance system to be successful, a continuous flow of fund must be guaranteed. From the statistics and research it can be drawn to inferences and can also conclude that the Fund has performed below expectations. Response to the fund has been very poor. The total number 1.285 million contributed estimated that is at variance with about 8-10 million employees are yet to be brought into the contributory system (FMBN 1999). N4 billion collections and N100 million disbursements are two figures that show no correlation. The following questions are therefore pertinent.

- Why is Government not contributing into the fund?
- Why are people unwilling to participate?
- Why are contributors not accessing NHF?
- Does housing financing problem defy solution?

## **Possible problems associated with the industry**

### **Cost of Construction and Income**

It is not within the scope of this paper to dwell elaborately on the abnormal cost of housing as we experience today. Since cost or price is a function of demand and supply. The cost at which the houses reach the market will go a long way to determine affordability. Where per unit cost is abnormally high as we have today, the simple implication is that few people will be able to afford it. The limited finance will not be able to spread around the potential homeowners. Repayment period is also increased making it impossible to revolve the loan around many people with a short period.

According to research and findings the gap between income and shelter cost in Nigeria is very wide. This has eliminated the low-income earners from the housing market. High cost had been attributed to the following:

- Rising cost of building materials, inflation rate in the economy,
- High space and quality standard adopted by designers,
- Fees of professional involved in housing designs and construction,
- Excessive profit of contractors.

### **Land**

Land question constitutes a major problem in home ownership or housing development. The degree of accessibility in terms of availability and cost remain a big challenge. The cost of urban land is a big discouragement to urban poor. Only marginal land, with no title document and infrastructure at the periphery are available for the poor to build on. This has resulted into urban sprawl and housing development that can not qualify as homes. The cost of processing title document is exorbitant and also a major concern. Perfecting land documents takes minimum of two years and is like camel passing through the proverbial eye of the needle Cost of land and documentation account, in most cases, for about half of what is required for housing development.

### **Construction Industry**

The absence of large real estate development companies with access to the relevant technology and financial muscle to develop cheap houses on mass scale for the urban poor is a drawback to our housing delivery system. This absence of big time developers has discouraged the development and local production of low cost building materials on a commercial basis. The reliance of more builders on imported conventional building materials has led to high cost of construction, thereby compounding the problem of affordability. Proliferation of low quality contractors is also a major problem in the building industry. According to research and findings the reliance on quacks is one of major back in the industry. There is acute shortage of skilled personnel in various trades. The large multinational firms employ the few skilled persons.

### **Savings**

Whatever organizational form a housing financing system takes - saving and loan association, building society, national housing bank, or some combination of these - no single aspect of its operation is likely to determine its success or failure than its ability to mobilize savings (Christian, 1980). This involves a proper understanding of the three basic

motives for holding money - transaction balance, contingency balance and investment balance. There is a presumption that saving or fund market divide between transaction balances, which gravitate towards commercial banks.

Contingency balance - which are the natural milieu of housing finance institutions, and investment balance, under which money tends to flow to the highest bidder and constitute a major source of fund for the broader capital market. Inability to understand the need for balance has led to loss of saving habit. Before the Structural Adjustment Program when the economy was enjoying boom, Nigerians developed propensity to consume indiscriminately. Our attitude towards materialism has led to lack of value and perversion of every known social ethics.

- **Voluntary Saving:** This is the basic operation of the financial institutions industry, commercial banks, finance houses and merchant's banks. Many lost their savings to distress and liquidated banks creating a big distortion in the saving culture.
- **Compulsory Savings:** National Housing Fund provided that 2.5% of the income of workers be paid to the fund as mandatory savings. This has generated a lot of controversy and criticism. Some called for the abrogation of the scheme, but later demonstrated how similar scheme was used to transform the housing sector in Korea.

### **EXPERIENCE OF OTHER NATIONS**

Many have stated why Mortgage banking that worked in other nations could not work in Nigeria. Previous studies and research reported on housing finance in Korea and Germany respectively. These findings revealed the success stories of the two countries in the area of housing finance.

## **SUGGESTED APPROACHES FOR IMPROVED HOUSING IN NIGERIA**

**Integrated Rural Development:** Government must pursue radical development of the rural economy. Any policy that encourages rural development will help eliminate unemployment, slum formation, and perpetual increases in demand for housing and stress on urban infrastructure. It will also check mass rural-urban migration. Rural housing problem is qualitative. Adequate measure should be taken to provide the much-needed infrastructure to awake the slumbering economy.

**Housing Education:** It is funny to know that it is only in the year 2000 that Housing as a course of study at MSc, level commenced at the University of Ibadan. This is belated but it is better late than never. More housing programs should be run by our Educational Institutions. This will provide the expertise and direction needed. Apart from that, there is need to embark on public enlightenment programs capable of giving the right focus to housing.

**Federal Ministry of Housing:** The current state of housing in Nigeria and the deficit of housing stock that requires millions of units to satisfy require a separate ministry for the task. The present incremental approach of uncoordinated institutions cannot achieve anything. There is need for a comprehensive approach through a ministry whose day to day responsibility is housing.

**Co-operative Societies/Building Associations:** The importance of co-operative societies was recognized in the NHP. They form part of the second tier of the mortgage banking structure. It is therefore imperative that the legal framework for their formation and how they can access the fund be made clear and popularized. This appears to be a more feasible option considering their existence in our traditional settings and their success story in thrift business. Membership of a recognized society is enough to access the fund. This can help to eliminate the bottleneck of stringent conditionality that prevents people from applying for loans from the fund. Loan guarantees by Co-operatives should be sufficient. The danger of not adopting this cannot be over emphasized for the following reasons:

- (1) People have lost confidence in Mortgage Bankers – It will take some time for the situation to be reversed.
- (2) If the fund is not accessed, it will be a total loss to Nigeria as the so-called accumulation today exists only on paper. It is better for the poor to have their money at the risk of defaulting, than for the money to be lost to looters and embezzlers.

**House improvement Loan:** If cost of constructing new houses is not within the reach of people, revitalizing the existing stock can increase housing stock. Loans should be made available for house improvement. Evidence of ownership of existing building offers better collateral security. Approved building plan in this case should be sufficient for mortgage loan.

**Decree 54(1979):** Employee Housing Scheme (Decree 54 of 1979) should be implemented. Audited Annual Report of companies that fall under the scheme should include information on housing provision for their staff. The housing units should be owner-occupied.

**Building Cost / Income:** Increase in income is of little relevance if the cost of construction remains high. Increase wage in this circumstance will only satisfy the propensity of Nigerian towards materialism.

- Alternative building approach such as system housing should be exploited
- Local Building materials should be used for government project. This leadership by example is long overdue. Like West Africa Portland Cement Company.
- Building materials manufacturing companies should be privatized to ensure profitability.
- Industrialization of housing and development of construction sector should receive government's urgent attention.

**Land:** A Section of the NHP (1991) promised to look into the land policy for possible revision where necessary. A promise that was not kept for about 10 years is a deceit. If land is accepted to be one of the main pillars of housing delivery, the provisions of the Act that constitute bottlenecks to easy access should be removed to make it relevant. There is no doubt that the Act has increased land cost. Its requirement of certificate of occupancy, which is not easy to obtain, is a major problem to those seeking mortgage loan.

**Housing Finance through Bond:** There had been sharp criticism of over design and consumption of imported building material. Some countries use compulsory bond purchase as a condition of building permit issue or the granting of a mortgage loan. Often such approaches have a dual purpose – to discourage the construction of luxury housing and to provide a special fund for low – income housing or infrastructure. In this mode, the value of the required bond purchase is scaled to the cost of construction cost, such that for building permit above a certain level of construction cost, bond equivalent to, say 15% of the cost of construction is purchased. Below a certain level, no bond purchase is required as a precondition for issuance of a building permit or mortgage loan. This should be considered for adoption.

**FMBN/NBRRI:** FMBN must be reengineered to enable her collaborate with NBRRI for regular funding of research into cheaper building material and development of building industry

**Compulsory Saving:** Rather than being abolished this should be properly administered. In nations where it worked best, the ministry of works and Housing is always involved. This allows for investment in infrastructure development from the fund. With this, the poor are guarantee access to pipe borne water, electricity etc.

**PMIs (Diversification of Portfolio):** This should be deferred till PMIs are able to prove that they have complete mastery of their primary assignment. Any operation that will induce diversion of fund should for now be in the cooler.

**Support Facilities and Saving Promotion:** Saving promotion is an essential element of savings mobilization, but in order to mobilize and retain a major share of potential savings, a housing finance institution must not only provide security for the depositor fund and access to long-term mortgage credit, it must also offer an “adequate” rate of return in deposits. Adequate rate of return depend on:

- Rate of interest paid by other financial institutions or comparable deposit
- Degree of competition for fund in savings.
- Rate of inflation and
- Effective demand for mortgage credit.

**Securitization as an Alternative Source of Housing Finance:** Securitization of real estate financing is the conversion of assets (illiquid assets i.e. bank loans) into readily tradable financial assets i.e. securities. Securities are appropriate vehicles for the repackaging/restructuring of risk assets into forms that are liquid, divisible i.e. unit sale,

qualitative and market friendly. It is also an excellent receptacle pool for equities. Securities will open the world of commercial and mortgage properties to the investing and general public. That will allow property to be more actively traded in, with increased turnover, income and investment pull. Securitization will help overcome the intrinsic negative perception of property as a poor, inefficient investment medium.

A restructure of real estate finance through securitization will benefit all the parties in the real estate finance market, investors, banks etc. Furthermore, real property needs to be Depersonalized, this is what securitization does and by this, makes home mortgage a bond (security).

### Conclusion

In considering the Housing system, it is imperative to make it effective – based on research and findings the housing system has a social and economic effect on any nation. Most developed nations have a close to effective if not effective system which is most time reflected in the social and economic build up or structure (e.g. UK, certain parts of USA, Russia Germany and Korea).

The trend it falls follows falls under 4 main constraints, although finance methods are available the cue falls on the awareness program for the methods available to set the set target.

Most of the issues around the housing system in Nigeria fall under;

- Financial empowerment – average wage, cost of living and material, interest rate matching real economic standards etc.
- Technology – it being cost effective to produce on a large scale to satisfy demand and market structure.
- Cost of land
- Government policies

An effective housing finance system is one that can mobilize consumer savings and investor capital and provide adequate housing loans to those in need at the lowest cost in accordance with the country's legal system, economy and general social conditions.

In the writer's opinion, the following factors contribute to an effective housing finance system in any country:

- The government should enact a law on land zoning according to use. Such zoning can be adjusted every ten years by public hearing corresponding to urban expansion. This enables the government to appropriately formulate policy on resource allocation, environmental management and to appropriately provide a public utility system, which prevents disorderly urbanization in the future.
- There should be a law supervising real estate developers. A real estate developer is to market a project with good building standards and public utilities adequately corresponding to housing density, with no harm inflicted upon the environment. The law must protect the consumers and should stipulate that a developer who markets a project to sell land inclusive buildings at a price of more than a set

figure per one housing unit must allocate not less than 20% of the project for the construction of the housing inclusive of land to sell at a price lower than set figure per one housing unit. This will enable low-income people to own their home in a location not too far from the urban areas with good public utilities..

- The Government should have laws to deal with land ownership, the use of land for making a living and the use of land for proper dwelling.
- The Government should have effective laws on bankruptcy and on mortgage enforcement.
- The FMBN should transform into a viable Secondary Mortgage Market operator, functioning as a middleman who buys housing credits and performs securitization of assets thereafter sell them to various funds and life insurance companies, which minimizes the financial institutions' risks on liquidity, funds mismatching and an inadequacy of funds for risky assets.

With all this in consideration we as a nation have to push for an effective system so as to eradicate some social and economic issues that contribute generally to poverty. A decade ago some nations realized that the housing system was a core contributor to the positive growth of their nation and set standards, policy and methods that have in many ways changed their economy directly or indirectly (e.g. Korea, Thailand, Germany etc.)